

A "retailer maintaining a place of business in Illinois" is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.201 and 150.801. (This is a GIL.)

December 8, 1998

Dear Ms. Xxxxx:

This letter is in response to your letter dated September 9, 1998. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

Based upon the facts as stated below, COMPANY requests a written ruling concerning the correct sales tax rates to collect from our Illinois clients.

COMPANY provides computer services to the insurance and automotive repair industries. Generally our products fall into two categories, information services and computer systems. The information service portion of the business is in the form of a database of automotive information which the client can access from our host computer through phone systems. The computer systems are estimating systems which are sent to the client on CD-Rom for installation on their own hardware or installed on personal computers owned by COMPANY which are then leased to the client. Monthly updates to the program are sent to clients on CD-Rom. All products are sent by common carrier from locations outside of Illinois. Typically, COMPANY does not install these products at the client's location and most client contact would be in the form of telephone support. Client training may take place at the client's Illinois location or at COMPANY's location in Elk Grove Village.

The corporate offices of COMPANY, are located in CITY1/STATE. Most senior executives, accounting and technical personnel are located at this office. The company also maintains an office in CITY2, Illinois. Personnel at this office include: account executives, sales and training personnel, and clerical staff.

Sales are solicited by advertising, cold calls, trade shows and proposal requests from insurance companies. While sales people may demonstrate a product at the client's location in Illinois, our Illinois location is not a retail location and customers would not come there to purchase products. Virtually all of our products are on-going in nature and set up with a contract between COMPANY and the Client. While the preprinted, standard contract may be prepared in Illinois and signed by the client at their location, contracts are not

considered valid by COMPANY until a senior executive in the CITY1 office approves and signs it. This policy is stated as such on the client contract.

Please respond in writing as to whether COMPANY should be collecting and remitting the state rate only, the state and local rates at our clients locations or the rate at our CITY2 location. Call or write if you need additional information. Thank you.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Cause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

For your information, we have enclosed a copy of 86 Ill. Adm. Code 270.115 which is the regulation regarding Jurisdictional Questions related to the Home Rule Municipal Retailers' Occupation Tax. As you will note, it is the Department's opinion that the sellers' acceptance of the purchase orders or other contracting action in the making of the sales contract is the most important single factor in the occupation of selling. If purchase orders are accepted at the sellers' place of business within the municipality, the sale is at retail, and the purchasers receive physical possession of the property in Illinois, the

sellers incur Home Rule Municipal Retailers' Occupation Tax liability in that home rule municipality.

If purchase orders are accepted outside this State, but the tangible personal property which is sold is in an inventory of the retailers located within a Home Rule municipality at the time of its sale, or is subsequently produced in the Home Rule municipality, then delivered to the purchasers in Illinois, the place where the property was located at the time of the sale, or at the time it was subsequently produced, will determine where the seller is engaged in business for Home Rule Municipal Retailers' Occupation Tax purposes regarding that sale.

When the purchase orders are not accepted in Illinois, nor is the property located in Illinois at the time of the sale or when it is subsequently produced, the transactions will not be subject to Home Rule tax. The transactions will, however, be subject to Illinois Use Tax, which sellers having a physical presence in this State must collect and remit.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax.

A license of software is not a taxable retail sale if:

- A) it is evidenced by a written agreement signed by the licensor and the customer;
- B) it restricts the customer's duplication and use of the software;
- C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);
- D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) the customer must destroy or return all copies of the software to the vendor at the end of the license period.

As stated above, licenses of computer software are not taxable if they meet all of the criteria listed in Section 130.1935(a)(1). However, item (D) of that part requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed software license agreements to have met this criteria if the agreements do not contain a provision about the loss or damage of the software, but the vendors' records reflect that they have a policy of

providing copies of software at minimal or no cost if the customers lose or destroy the software.

Item (E) of this part also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. The Department has also deemed perpetual license agreements to qualify for this criteria even though no provision is included in the agreements that requires the return or the destruction of the software.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. Please refer to 86 Ill. Adm. Code Sec. 130.1935(b), enclosed. The taxability of maintenance agreements depends upon if charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance agreements are sold separately from tangible personal property, sales of the agreements are not taxable transactions. However, when maintenance services or parts are provided under the maintenance agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See the enclosed copy of 86 Ill. Adm. Code 140.301(b)(3).

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreements would be taxable as sales of canned software.

Assuming that the services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax. Contingency plans or agreements to provide back up computer systems in the event of a disaster are not sales of tangible personal property and are not subject to tax.

I hope this information is helpful. The Department of Revenue maintains a Web site which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.